No. 14-400

IN THE

Supreme Court of the United States

CHARLES E. HARRIS, III,

Petitioner,

v.

MARY K. VIEGELAHN, CHAPTER 13 TRUSTEE,

Respondent.

On Writ Of Certiorari
To The United States Court of Appeals
For The Fifth Circuit

BRIEF FOR THE PETITIONER

J. TODD MALAISE
STEVEN G. CENNAMO
MALAISE LAW FIRM
909 N.E. LOOP 410, STE. 300
SAN ANTONIO, TEXAS 78209
(210) 732-6699

MARK T. STANCIL
Counsel of Record
ALAN E. UNTEREINER
MATTHEW M. MADDEN
ERIC A. WHITE
ROBBINS, RUSSELL, ENGLERT, ORSECK, UNTEREINER & SAUBER LLP
1801 K STREET, NW
WASHINGTON, D.C. 20006
(202) 775-4500
mstancil@robbinsrussell.com

QUESTION PRESENTED

Chapter 13 of the Bankruptcy Code allows debtors to turn a portion of their monthly income over to a Chapter 13 trustee for distribution to creditors. At any time, however, a debtor may convert a Chapter 13 bankruptcy case to a Chapter 7 case. So long as that conversion is made in good faith, the resulting Chapter 7 estate comprises the debtor's property as of the date the original Chapter 13 petition was filed; it does not include wages or property that the debtor acquired *after* the petition date. See 11 U.S.C. § 348(f).

The question presented is:

Whether, when a debtor converts a bankruptcy case to Chapter 7 after confirmation of a Chapter 13 plan, undistributed funds held by the Chapter 13 trustee are refunded to the debtor (as the Third Circuit held in *In re Michael*, 699 F.3d 305 (2012)) or distributed to creditors (as the Fifth Circuit held below).

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BRIEF FOR THE PETITIONER

OPINIONS BELOW

The opinion of the Fifth Circuit (Pet. App. 1a–28a) is reported at 757 F.3d 468. The district court's decision (Pet. App. 29a–49a) is reported at 491 B.R. 866. The bankruptcy court's opinion (Pet. App. 50a–51a) is unreported.

JURISDICTION

The Fifth Circuit issued its decision on July 7, 2014. The petition for a writ of certiorari was granted on December 12, 2014. This Court's jurisdiction rests on 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

In pertinent part, 11 U.S.C. § 348 provides:

(e) Conversion of a case under section 706, 1112, 1208, or 1307 of this title terminates the service of any trustee or examiner that is serving in the case before such conversion.

(f)(1) Except as provided in paragraph (2), when a case under chapter 13 of this title is converted to a case under another chapter under this title—

(A) property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition, that remains in the possession or is under the control of the debtor on the date of conversion;

* * * * *

(2) If the debtor converts a case under chapter 13 of this title to a case under another chapter under this title in bad faith, the property of the estate in the converted case shall consist of the property of the estate as of the date of conversion.

11 U.S.C. § 1327 provides:

(a) The provisions of a confirmed plan bind the debtor and each creditor, whether or not the claim of such creditor is provided for by the plan, and whether or not such creditor has objected to, has accepted, or has rejected the plan.

(b) Except as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor.

(c) Except as otherwise provided in the plan or in the order confirming the plan, the property vesting in the debtor under subsection (b) of this section is free and clear of any claim or interest of any creditor provided for by the plan.

STATEMENT

This case is about wages earned by a debtor *after* he files for bankruptcy. As a general matter, how post-petition wages are treated depends on whether the debtor is proceeding under Chapter 13 of the Bankruptcy Code (in which a debtor retains his assets during bankruptcy subject to a court-approved payment plan) or Chapter 7 (in which the debtor's assets are liquidated and the proceeds distributed to creditors). In a Chapter 13 case, post-petition wages are "property of the estate"; in a

Chapter 7 case, they are not. See 11 U.S.C. §§ 541, 1306.

But what happens when a debtor converts a Chapter 13 case to Chapter 7, which he is statutorily authorized to do "at any time"? 11 U.S.C. § 1307(a). More particularly, if the Chapter 13 trustee already holds some of the debtor's post-petition wages when the case is converted, may she distribute those to creditors even though it is now a Chapter 7 case?

The answer is no. Congress has provided that, "[e]xcept" when a debtor makes the conversion "in bad faith," those wages do not remain "property of the estate" in the converted case. 11 U.S.C. § 348(f). Moreover, conversion "terminates the service" of the Chapter 13 trustee, 11 U.S.C. § 348(e), who had been acting as "the representative of the estate," 11 U.S.C. § 323(a). That is, the act of conversion immediately removes the case from Chapter 13 and puts it into Chapter 7; only when a conversion is made "in bad faith" does the debtor's post-petition property follow the estate into the Chapter 7 case and remain available to creditors. That result is dictated by the statutory text, and it fully squares with the Bankruptcy Code's purpose to encourage debtors to attempt to repay their debts in Chapter 13 rather than immediately resort to liquidation under Chapter 7. The court of appeals reached the opposite result, but only by criticizing petitioner for reading the statute "too literally." Pet. App. 10a (quoting *In re Parrish*, 275 B.R. 424, 430 (Bankr. D.D.C. 2002)).

1. The commencement of a bankruptcy case under any chapter of the Bankruptcy Code creates an estate. 11 U.S.C. § 541(a). In a Chapter 7 case, the debtor's assets are sold and the proceeds

distributed to creditors. The "property of the estate" comprises the debtor's property "as of the commencement of the case." 11 U.S.C. § 541(a)(1). That "estate is placed under the control of a trustee, who is responsible for managing liquidation of the estate's assets and distribution of the proceeds." *Law* v. *Siegel*, 134 S. Ct. 1188, 1192 (2014) (citing 11 U.S.C. § 704(a)(1)). Liquidation is commenced, debts are discharged, and the debtor keeps whatever property he acquired after the commencement of the case. 11 U.S.C. § 727(b). It is a salient feature of Chapter 7 bankruptcies that creditors recover very little on their claims, and often nothing at all. See, *e.g.*, *Wachovia Mortgage* v. *Smoot*, 478 B.R. 555, 560 (E.D.N.Y. 2012).

By contrast, an "individual with regular income," and with debts under certain limits, may commence a case under Chapter 13. 11 U.S.C. § 109(e); see also 11 U.S.C. § 101(30). Debtors proceeding under that chapter "must agree to a court-approved plan under which they pay creditors out of their future income." *Hamilton* v. *Lanning*, 130 S. Ct. 2464, 2469 (2010). In return, "[u]nlike debtors who file under Chapter 7 and must liquidate their nonexempt assets in order to pay creditors, Chapter 13 debtors are permitted to keep their property." *Id.* at 2468–2469 (internal citations omitted); see also 11 U.S.C. § 1306(b) ("Except as provided in a confirmed plan or order confirming a plan, the debtor shall remain in possession of all property of the estate."). Under Chapter 13, the "property of the estate" expands to include most property "that the debtor acquires *after* the commencement of the case," including any "earnings from services performed by the debtor *after*

commencement of the case"—*i.e.*, his post-petition wages. 11 U.S.C. § 1306(a)(1), (2) (emphasis added).

A Chapter 13 debtor must propose a plan that will repay his creditors within three to five years. 11 U.S.C. §§ 1321, 1325(b)(4). The debtor must agree to repay secured creditors in full (or else to surrender the collateral), and to pay unsecured creditors at least as much as they would have received in a Chapter 7 liquidation of petitioner's assets. 11 U.S.C. § 1325(a)(4), (5). Moreover, the debtor must commit his post-petition "disposable income" to the plan. 11 U.S.C. § 1325(b); see also *Ransom* v. *FIA Card Servs., N.A.*, 131 S. Ct. 716, 721–722 (2011). To that end, a Chapter 13 plan must "provide for the submission * * * to the supervision and control of the trustee" of either "all" the "future earnings or other future income of the debtor" or "such portion of" the debtor's future earnings and income "as is necessary for the execution of the plan." 11 U.S.C. § 1322(a)(1). The court can order the debtor's employer "to pay all or any part of such income to the trustee." 11 U.S.C. § 1325(c).

In sum, under Chapter 13—but not under Chapter 7—a debtor devotes a substantial part of his post-petition income to repaying his creditors over time. A debtor must elect to adjust and repay his debts under Chapter 13, and only the debtor may commence such a proceeding—there is no such thing as an involuntary Chapter 13 proceeding. See 11 U.S.C. § 303(a). Likewise, "[t]he debtor may convert a case under [Chapter 13] to a case under chapter 7 * * * at any time." 11 U.S.C. § 1307(a). "Any waiver of the right to convert * * * is unenforceable." *Ibid.* The debtor converts his own case immediately upon

filing a notice of conversion. 11 U.S.C. § 1307(a); Fed. R. Bankr. P. 1017(f)(3); see also 8 *Collier on Bankruptcy* ¶ 1307.02, at 1307-6 (16th ed., Alan N. Resnick & Henry J. Sommer eds., 2012) ("Once the debtor files a notice of conversion, the conversion is automatic and immediate.").

Section 348 of the Bankruptcy Code specifies the "effect" of a conversion from Chapter 13 to Chapter 7: "[W]hen a case under chapter 13 * * * is converted to a case under another chapter * * * property of the estate in the converted case shall consist of property of the estate, *as of the date of filing of the petition*, that remains in the possession of or is under the control of the debtor on the date of conversion." 11 U.S.C. § 348(f)(1) (emphasis added). There is only one "[e]xcept[ion]": When a debtor converts in bad faith, "the property of the estate in the converted case shall consist of the property of the estate *as of the date of conversion*." 11 U.S.C. § 348(f)(2) (emphasis added).

The conversion also immediately "terminates the service of any trustee * * * that is serving in the case before such conversion." 11 U.S.C. § 348(e). An interim trustee under Chapter 7 is then appointed "[p]romptly" (11 U.S.C. § 701) to be the new "representative of the estate" (11 U.S.C. § 323(a)). The Chapter 13 trustee's remaining duties, which are specifically enumerated by statute and rule, are limited to certain administrative tasks designed to wrap up the now-converted Chapter 13 case. These duties are to turn over records and property of the estate in the trustee's possession to the new Chapter 7 trustee, see Fed. R. Bankr. P. 1019(4), and to file a final report and account of the trustee's

administration of the estate under Chapter 13, 11 U.S.C. §§ 704(a)(9), 1302(b)(1); Fed. R. Bankr. P. 1019(5)(B)(ii).

2. In early 2010, petitioner Charles E. Harris, III, fell $3,700 behind on the (then-underwater) mortgage he had taken out on his home in the outskirts of San Antonio. Pet. App. 3a; Bankr. Pet. Schedule A, *In re Harris*, No. 10-50655, Doc. 1 (Bankr. W.D. Tex. Feb. 24, 2010) ("Bankr. Pet.").

a. After accounting for his basic living expenses, petitioner had just $530 a month left over from his paychecks. Bankr. Pet. Schedules I & J. Accordingly, he proposed a payment plan under which he would pay his mortgage arrears and other debts over 60 months out of $530 his employer would deduct from his wages each month and remit to the respondent, Mary K. Viegelahn, the Chapter 13 Standing Trustee for the San Antonio Division of the Western District of Texas. Pet App. 3a–4a; J.A. 34, 37. The plan specified that Harris's mortgage lender, Chase, would receive $352 per month on its secured claim for the mortgage arrears, and the only other secured creditor provided for in the plan, a consumer-electronics store, would receive an average distribution of $75.34 per month. J.A. 34.[1] Once those secured lenders were paid in full, the trustee would begin distributions to petitioner's unsecured

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[1] Additional funds would be disbursed to respondent as her percentage fee (see 28 U.S.C. § 586(e)(1)) and to petitioner's attorney (J.A. 35). The plan also provided for petitioner to give up his five-year-old car to his secured automobile lender. See J.A. 34; see also Pet. App. 27a n.12.

creditors. The bankruptcy court confirmed the plan in April 2010. Pet. App. 30a; J.A. 43–53.

Petitioner's plan also required him to continue making monthly mortgage payments directly to Chase as they came due. J.A. 34. Ultimately, however, petitioner fell behind on his mortgage payments again. Pet. App. 4a; Mot. for Relief from Stay, *In re Harris*, No. 10-50655, Doc. 22, at 3 (Bankr. W.D. Tex. Oct. 13, 2010) ("Mot. for Relief"). In October 2010, Chase moved to lift the automatic bankruptcy stay to begin foreclosure proceedings. *Ibid.* Petitioner did not oppose that relief, Pet. App. 4a, and the court granted the motion in November 2010, J.A. 6. At that point, as required by petitioner's confirmed Chapter 13 plan,[2] respondent stopped distributing $352 of petitioner's monthly wages to Chase because it had been granted leave to seek repayment of petitioner's mortgage arrears through foreclosure. Pet. App. 17a.

b. Having failed to save his home, petitioner filed a notice converting his case to Chapter 7 on November 21, 2011. Pet. App. 31a. It is undisputed that petitioner converted the case in good faith. He had tried to pay off all his debts over time, but could not keep up with payments on his $89,600 home, Bankr. Pet. Schedule C-1, for which he still owed Chase $133,159.40 in principal "plus accrued

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[2] The plan specified that "[i]f a creditor is allowed by Court Order to foreclose on, or otherwise take back his/her property, such creditor must notify the Chapter 13 Trustee immediately upon regaining the property. Upon entry of an Order Lifting Stay, the Trustee shall stop any further payment on that claim." J.A. 32.

interest, late charges, attorneys fees and costs," Mot. for Relief 3.

That conversion took effect immediately, see 11 U.S.C. § 1307(a); Fed. R. Bankr. P. 1017(f)(3), and automatically "terminate[d] the service" of respondent, 11 U.S.C. § 348(e). Indeed, the very next day, the bankruptcy court clerk updated the docket sheet to reflect that respondent had been "removed from the case" and an interim Chapter 7 trustee had been appointed. J.A. 7; see also Order Combined with Notice of Chapter 7 Bankruptcy Case, Meeting of Creditors, & Deadlines, *In re Harris*, No. 10-50655, Doc. 32, at 1 (Bankr. W.D. Tex. Nov. 22, 2011).

At the time of petitioner's conversion, and after he had assigned $1,200 to pay his attorneys' fees, respondent held $4,319.22 of petitioner's post-petition wages. Pet. App. 4a. On December 1, 2011—ten days *after* the conversion—respondent distributed those post-petition wages to Chapter 13 creditors instead of returning them to petitioner. *Ibid.* In the end, respondent handed out an additional $397.68 to the secured-creditor consumer-electronics store, $3,573.78 to six unsecured creditors, and $267.79 to herself as a percentage fee pursuant to 28 U.S.C. § 586(e)(1). Pet. App. 4a.

c. Petitioner moved to compel the refund of that money, arguing that respondent had distributed it without authority. Pet. App. 5a. Following a hearing, the bankruptcy court granted petitioner's motion and ordered respondent to refund to petitioner the money she had distributed to creditors (and herself) after petitioner converted to Chapter 7. *Id.* at 50a. At the hearing, the court held that "the language of the

statute is straightforward": "[Section] 348 says that conversion of the case under * * * [Section] 1307 * * * terminates the service of any trustee that is serving in the case before the conversion. So, the trustee can no longer be functioning as the trustee, and, therefore, can no longer be functioning as the disbursing agent." Tr. of Feb. 14, 2014 Hearing, *In re Harris*, No. 10-50655, Doc. 52, at 21 (Bankr. W.D. Tex. Mar. 13, 2012); accord *id.* at 22 ("[I]t looks to me like the statutory language is pretty clear."). The trustee's argument in support of her post-conversion distribution "presumes," incorrectly, the court held, "that the trustee is still the trustee." *Id.* at 21.

d. In the meantime, petitioner's case proceeded under Chapter 7. With his home and mortgage out of the case, petitioner's only remaining assets—household goods and personal effects, a small amount of cash, a $5,500 retirement account, and a modest future tax refund, see Bankr. Pet. Schedules C & C-1—were all exempt from his estate under 11 U.S.C. § 522(b)(2). Accordingly, petitioner's newly appointed Chapter 7 trustee reported to the court in December 2011 what had already been true for months: Petitioner had "no property available for distribution from the estate over and above that exempted by law." J.A. 8. On February 23, 2012, the bankruptcy court granted petitioner a discharge pursuant to Section 727 of the Bankruptcy Code. See Order Discharging Debtor, *In re Harris*, No. 10-50655C, Doc. 43, at 1 (Bankr. W.D. Tex. Feb. 23, 2012).

3. Respondent appealed the refund order, and the district court affirmed. Pet. App. 29a–49a.

The court "agree[d] with the Third Circuit's reasoning" in *In re Michael* that "the funds in question must be returned to the debtor." Pet. App. 34a. It held "that 11 U.S.C. § 348(e) prohibits a Chapter 13 trustee from disbursing, after conversion to Chapter 7, plan payments made by the debtor prior to conversion." *Id.* at 48a. Upon conversion from Chapter 13 to Chapter 7, the district court explained, "[a] plain reading of § 348(f)(1)(A) would seem to establish * * * that the funds should not be considered part of the Chapter 7 estate in the absence of a bad-faith conversion." *Id.* at 38a. The court reasoned that Congress's answer to bad-faith conversions in Section 348(f)(2) "support[s]" "the idea that Congress would want the disputed funds to be returned to [the] [d]ebtor" upon his good-faith conversion. *Id.* at 47a.

The district court further concluded that, "when a case is converted from Chapter 13 to Chapter 7, the order converting the case is effectively backdated to the date on which the Chapter 13 petition was filed." Pet. App. 37a. "Accordingly, the Code provides that 'property of the estate in the converted [Chapter 7] case shall consist of property of the estate, *as of the date of filing of the [Chapter 13] petition*, that remains in the possession of or is under the control of the debtor on the date of conversion.'" *Ibid.* (quoting 11 U.S.C. § 348(f)(1)(A)). And the court rejected respondent's arguments that creditors were entitled to the funds: The Code, it held, neither vests creditors with a right to undistributed post-petition wages, nor permits the distribution of those funds to creditors upon conversion from Chapter 13. See *id.* at 48a–49a (discussing 11 U.S.C. §§ 1326(a)(2), 1327).

The district court's interpretation of the statutory text accorded with Congress's intent. The Bankruptcy Code, the court explained, implements a "Congressional policy of encouraging debtors to attempt a Chapter 13 bankruptcy—through which a debtor will pay his creditors at least as much and likely more than he would have under Chapter 7." *Ibid.* Such a policy of encouraging resort to Chapter 13 can be achieved, the court concluded, only if the debtor can convert to Chapter 7 "without penalty if that attempt fails." *Ibid.* And to whatever extent its holding might "incentivize bad-faith conversions" to "game the system," the district court stated that Section 348(f)(2) of the Bankruptcy Code provided Congress's response. Pet. App. 47a.

The approach urged by respondent, in contrast, "would create" a powerful reason for debtors to avoid Chapter 13 altogether—"precisely the kind of disincentive to file a Chapter 13 bankruptcy that Congress was trying to avoid." Pet. App. 48a. A debtor's post-petition wages, the court noted, are not included in a Chapter 7 estate, and a debtor who elects to proceed under Chapter 7 from the start puts those funds beyond the reach of his creditors. See *id.* at 47a–48a. But a debtor who chooses to put those funds *within reach* of his creditors in order to attempt to make a Chapter 13 plan work should not be penalized by the loss of *more of* those funds to his creditors if such a plan later proves unworkable. See *ibid.* A Chapter 13 trustee's post-conversion disbursement to creditors of a debtor's post-petition wages, the court held, is antithetical to that policy. *Id.* at 43a–45a.

Finally, the district court observed that there is "nothing unfair about returning [undistributed, post-petition wages] to a debtor rather than to his creditors." Pet. App. 46a. During the pendency of the Chapter 13 case, creditors would already "have had the benefit of distribution from debtors' wage contributions, which would not have been available to them under Chapter 7." *Ibid.* (quoting *In re Boggs*, 137 B.R. 408, 410 (Bankr. W.D. Wash. 1992)).

4. Respondent appealed again, and a panel of the Fifth Circuit reversed. The court of appeals held that, notwithstanding petitioner's good-faith conversion to Chapter 7, his post-petition wages were appropriately distributed to his creditors under his Chapter 13 plan. Pet. App. 5a–28a.

The Fifth Circuit found "little guidance in the Bankruptcy Code." Pet. App. 22a. Section 348(e)'s termination of the Chapter 13 trustee's "service" upon conversion, it said, should not be taken "too literally." *Id.* at 10a (quoting *In re Parrish*, 275 B.R. at 430); see also Br. in Opp. 15 ("Respondent posits that 11 U.S.C. § 348(e), which terminates a trustee's services upon conversion, cannot be taken too literally."). Although the panel found it "clear" that "after conversion, the debtor's continuing obligations under the [Chapter 13] plan * * * cease," and the plan no longer binds creditors, *id.* at 13a, it saw "no reason why" the Chapter 13 trustee's "power and duty to wrap up certain affairs of the estate" could not include "distributing the funds remaining in her possession" after conversion, *id.* at 14a. That is, the court viewed disbursing the post-petition funds as arguably akin to the outgoing trustee's other "ancillary[,] * * * administrative duties." *Id.* at 11a

(quoting *In re Michael*, 699 F.3d at 320 n.8 (Roth, J., dissenting)). Likewise, the panel did "not read * * * much into the fact that upon conversion, a Chapter 13 plan is 'no longer in force.'" *Id.* at 13a (discussing 11 U.S.C. § 348(e)). The panel disregarded Section 348(f) as not "explicitly stat[ing] what should happen to these funds." *Id.* at 9a.

The Fifth Circuit turned instead "to considerations of equity and policy," relying heavily on Judge Roth's dissent in *In re Michael*. See Pet. App. 22a–28a. It rejected respondent's argument that the Bankruptcy Code provides Chapter 13 creditors a "vested right to receive payments pursuant to a confirmed Chapter 13 plan once the debtor transfers the payments to the trustee." *Id.* at 14a (discussing 11 U.S.C. § 1326(a)); see also *id.* at 15a–22a (rejecting, for similar reasons, creditor-vesting arguments under 11 U.S.C. §§ 1326(c) and 1327)). Although it acknowledged that "payments made under the plan do not give creditors any vested rights to payment," the panel concluded that "the creditors' claim to the undistributed funds is superior to that of the debtor." *Id.* at 28a. Finally, the court asserted that the result would not render the Section 348(f)(2) bad-faith provision "superfluous," *id.* at 22a, because—at least in some cases—"undistributed post-petition wages paid to the trustee under the Chapter 13 plan constitute only a subset of the debtor's post-petition property," *id.* at 21a.

SUMMARY OF ARGUMENT

I. The plain language of the Bankruptcy Code answers the question presented. The court of appeals' refusal to read the statute "too literally,"

Pet. App. 10a (quoting *In re Parrish*, 275 B.R. 424, 430 (Bankr. D.D.C. 2002)), was error.

A. Petitioner's good-faith conversion of his case from Chapter 13 to Chapter 7 excluded his post-petition wages from the "property of the estate" available to his creditors. 11 U.S.C. § 348(f)(1)(A). Congress has stated that "[e]xcept" when a debtor makes such a conversion in bad faith, the post-conversion estate under Chapter 7 comprises *only* the property the debtor had at the time he filed his Chapter 13 petition, and *not* any property (including wages) he acquired afterward. 11 U.S.C. § 348(f). The Fifth Circuit's recognition of another, unstated exception, under which a debtor's post-petition wages may be distributed to creditors by a Chapter 13 trustee notwithstanding a good-faith conversion, contradicts the intended effect of Section 348(f)(1) and nullifies for such wages the effect of Section 348(f)(2)'s bad-faith exception.

B. Petitioner's conversion of his case from Chapter 13 to Chapter 7 immediately "terminate[d]" respondent's "service" as trustee of the estate. 11 U.S.C. § 348(e). Accordingly, respondent lost her statutory authority to disburse funds to creditors upon conversion. Respondent's remaining duties were specifically limited, by statute and rule, to "turn[ing] over to the Chapter 7 trustee any records and property of the estate in her possession or control, and * * * fil[ing] a final report and account." Pet. App. 10a (citing Fed. R. Bankr. P. 1019(4), (5)(B)(ii)). Those limited obligations on respondent to account for her previous administration of the estate are not a license to continue administering it.

C. Section 1327 provides that, "[e]xcept as otherwise provided in the plan or the order confirming the plan, the confirmation of a plan vests all of the property of the estate in the debtor." 11 U.S.C. § 1327(b). The confirmation order in this case "otherwise provided" (*ibid.*) that property of the estate would "revest" in the debtor "upon * * * conversion." J.A. 48. Such vesting of the estate's property in the debtor—whether it happened at confirmation (under the default rule) or upon conversion (as specified here)—directs the return of undistributed post-petition wages to a debtor who converts his case out of Chapter 13.

II. Returning post-petition wages to a debtor who converts to Chapter 7 in good faith removes an otherwise serious disincentive for debtors to attempt debt repayment under Chapter 13. That rule also avoids needless and illogical inconsistency between the effect of conversions and dismissals, and recognizes the debtor's superior interest in funds he voluntarily made available to his creditors in the first place.

A. Returning post-petition wages to a debtor who converts his case from Chapter 13 to Chapter 7 furthers Congress's goal of encouraging debtors to choose a Chapter 13 proceeding, and to stick with it as long as it is feasible. Once a debtor converts an unsuccessful Chapter 13 case to a Chapter 7 case, in which post-petition wages *never* would have been property of the estate, the post-conversion distribution of those wages to creditors penalizes the failed attempt. Because a debtor must elect to proceed under Chapter 13, 11 U.S.C. §§ 301–303, and can convert or dismiss a Chapter 13 case at any time,

11 U.S.C. § 1307(a), (b), such a penalty is contrary to Congress's intent.

B. The rule adopted below, by contrast, establishes an illogical inconsistency with the refund of a Chapter 13 debtor's post-petition wages *upon dismissal*. See 11 U.S.C. § 349(b)(3). That nonsensical result "would merely elevate form over substance," "inject a needless degree of extra work on the part of all concerned," and "creat[e] a trap for the unwary." *In re Michael*, 699 F.3d 305, 314 (3d Cir. 2012) (quoting *Arkison* v. *Plata (In re Plata)*, 958 F.2d 918, 922 (9th Cir. 1992)).

C. The Fifth Circuit's reliance on purported "considerations of equity and policy" (Pet. App. 22a) was misplaced. Returning post-petition wages to debtors at conversion would neither give debtors a "windfall" (*id.* at 25a (quoting *In re Michael*, 699 F.3d at 319 (Roth, J., dissenting)), nor deprive creditors of any "*quid pro quo*" (*id.* at 26a (quoting *In re Michael*, 699 F.3d at 320 (Roth, J., dissenting)). If anyone received a windfall here, it was petitioner's unsecured creditors. When petitioner converted, they received payments that they had not yet expected, and would not have been entitled to had petitioner originally filed under Chapter 7 or converted his case earlier. There is nothing untoward about returning a debtor's post-petition wages to him once his voluntary attempt to repay creditors out of those wages proves unsuccessful.

ARGUMENT

I. The Statutory Text Excludes Post-Petition Wages From The Post-Conversion Property Of The Estate And Terminates The Chapter 13 Trustee's Authority To Disburse Such Wages

Statutory interpretation, of course, must "start * * * with the language of the statute," giving words their "'ordinary or natural' meaning." *Bailey* v. *United States*, 516 U.S. 137, 144-145 (1995). When the text of the statute is clear, that is the "end of the matter." *Good Samaritan Hosp.* v. *Shalala*, 508 U.S. 402, 409 (1993) (quoting *Chevron U.S.A. Inc.* v. *Nat. Res. Def. Council, Inc.*, 467 U.S. 837, 842 (1984)). The statutory text here is pellucid: Congress directly addressed the "effect of conversion" from Chapter 13 to Chapter 7, declaring that a debtor's post-petition income is not included as property of the Chapter 7 estate and that the Chapter 13 trustee's service "terminates."

The court of appeals, however, said that the statute should not be read "too literally." Pet. App. 10a (quoting *In re Parrish*, 275 B.R. 424, 430 (Bankr. D.D.C. 2002)). The Fifth Circuit instead relied on its own "considerations of equity and policy." *Id.* at 22a. That was wrong. The Bankruptcy Code unambiguously provides that conversion both removes post-petition wages from the property of the estate—"[e]xcept" when the conversion is made in bad faith, 11 U.S.C. § 348(f)—and "terminates" the trustee's authority to disburse those wages to creditors, 11 U.S.C. § 348(e). Moreover, the Code requires that

those wages be returned to the debtor in whom ownership has revested. 11 U.S.C. § 1327(b).

A. Section 348(f) Excludes Post-Petition Wages From The Property Of The Estate Upon A Good-Faith Conversion

1. In a Chapter 13 case, the property of the estate includes property acquired, and wages earned, by the debtor "after the commencement of the case." 11 U.S.C. § 1306(a), (b). In a Chapter 7 case, by contrast, the property of the estate is generally limited to the debtor's "legal or equitable interests * * * in property as of the commencement of the case." 11 U.S.C. § 541(a)(1); see also 11 U.S.C. § 541(a)(6) (excluding "earnings from services performed by an individual debtor after the commencement of the case" from the property of the estate under Chapter 7).

Section 1307(a) authorizes a debtor to convert a Chapter 13 case to a Chapter 7 case "at any time." 11 U.S.C. § 1307(a). Several other Bankruptcy Code provisions govern the "effect of conversion." Most relevant here is Section 348(f), through which Congress "expresse[d]" its "preference as to what property belongs to a debtor after conversion." *In re Michael*, 699 F.3d at 309. That provision specifies that a conversion from Chapter 13 to Chapter 7 redefines the property of the estate to comprise only such property that both existed when the debtor commenced his case *and* remains in his possession or control. More specifically, Section 348(f)(1)(A) provides:

> Except as provided in paragraph (2), when a case under chapter 13 of this title is converted to

> a case under another chapter under this title * * * *property of the estate in the converted case shall consist of property of the estate, as of the date of filing of the petition*, that remains in the possession of or is under the control of the debtor on the date of the conversion.

11 U.S.C. § 348(f)(1)(A) (emphasis added).

Thus, the statute expressly limits the property of a converted estate to the property the debtor held on the date he filed his original bankruptcy petition. In effect, this provision resets the property of the estate to include only those assets that would have been included if the debtor had proceeded under Chapter 7 all along and that are still in his possession and control. Property and wages accumulated as "property of the estate" *after* "the date of filing of the petition" under Chapter 13 are excluded from the post-conversion estate going forward under Chapter 7.

The exception "provided in paragraph (2)" confirms what is plain on the face of Section 348(f)(1)(A). Paragraph (2) states that "[i]f the debtor converts a case under chapter 13 of this title to a case under another chapter under this title *in bad faith*, the property of the estate in the converted case shall consist of the property of the estate as of the date of conversion." 11 U.S.C. § 348(f)(2) (emphasis added). Thus, post-petition property is pulled into the converted estate only if the debtor has converted his case in bad faith.[3] It follows that where the

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[3] "An example of such a bad faith conversion would be when the debtor never had any intention of proceeding with a chapter 13 plan and filed the chapter 13 case solely to obtain

conversion is made in good faith, the debtor's post-petition property and wages are—as provided by Section 348(f)(1)(A)—*excluded* from the property of the converted estate. See *In re Michael*, 699 F.3d at 314. Such property "will normally revert to the debtor." 3 *Collier on Bankruptcy* ¶ 348.02, at 348-9. That is where this case should end.

The Fifth Circuit's review of the "statutory arguments" gave scant attention to Section 348(f). See Pet. App. 9a–22a. It noted that the statute does not "explicitly" direct a Chapter 13 trustee to return undistributed post-petition wages to the debtor upon conversion. *Id.* at 9a. But such a provision is entirely unnecessary, since Section 348(f)(1) defines the property of the estate upon conversion not to include post-petition wages. In any event, Congress's decision to create in Section 348(f)(2) an exception for bad-faith conversions, where the undistributed post-petition wages *would* be included in the estate, logically requires that those wages *would not* be included in the estate in good-faith conversions. See *In re Michael*, 699 F.3d at 308–309.

The Fifth Circuit observed, however, that in some cases a converting debtor who has earned post-petition wages may also possess *other* property that was acquired post-petition. The debtor's potential loss of *that other* property would adequately deter bad-faith conversion, the court suggested, even if

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delay, with the intention of converting at a later date to take advantage of Section 348(f). Other examples might be cases in which debtors fraudulently transferred estate property or dissipated estate assets in bad faith." 8 *Collier on Bankruptcy* ¶ 1306.04, at 1306-9.

post-petition wages held by the trustee are lost to creditors following any kind of conversion. Pet. App. 21a–22a. For that reason, the court concluded, at least "in most cases" allowing a Chapter 13 trustee to distribute post-petition wages to creditors after good-faith conversions would not render Section 348(f)(2)'s penalty against bad-faith conversions "superfluous." *Id.* at 22a.

With respect, the Fifth Circuit missed the point. A debtor's post-petition wages are *among* the post-petition property that Congress intended for debtors to retain upon a good-faith conversion to Chapter 7, and to lose to creditors through a Chapter 7 liquidation only upon a bad-faith conversion. See *In re Michael*, 699 F.3d at 315. It is no answer to say, as the court of appeals did below, that *enough* of Congress's intent is respected that it is acceptable to ignore *part* of Congress's design. Cf. *United States* v. *Vonn*, 535 U.S. 55, 72 (2002) (pointing to, as "reason to doubt that Congress could have intended" a particular result, "the tendency it would have to undercut the object" of a congressional enactment); *N.L.R.B.* v. *Bildisco & Bildisco*, 465 U.S. 513, 542 (1984) ("[A] construction that does not serve the goals of the statute is to be avoided unless the words chosen by Congress clearly compel it.") (internal quotation marks omitted). Nor is there any reason to believe that Congress, which pointedly failed to include any such exception for post-petition wages (although it would have been easy to do so), regarded the inclusion of post-petition wages in this scheme as too much of a good thing. At bottom, by holding that a debtor's post-petition wages go to creditors whether he converted in good faith or bad, the Fifth Circuit inexplicably treats sinners and saints alike,

notwithstanding Congress's decision to treat them differently.

2. The "background and legislative history" of Section 348(f) strongly "confirm this textual reading." *Shell Oil Co.* v. *Iowa Dep't of Revenue*, 488 U.S. 19, 26 (1988). Congress enacted Section 348(f) in 1994 "to resolve a split in the case law about what property is in the bankruptcy estate when a debtor converts from chapter 13 to chapter 7." H.R. Rep. No. 835, 103d Cong., 2d Sess. 57 (1994), *reprinted in* 1994 U.S.C.C.A.N. 3340, 3366. Some lower courts had concluded that property of the estate acquired *during* a Chapter 13 case (including post-petition wages paid to the trustee) remained property of the estate notwithstanding conversion to Chapter 7. Congress enacted Section 348(f) to "overrule[]" those cases, and to "clarify" that the property a debtor acquires after filing a Chapter 13 petition does not remain property of the estate in a converted Chapter 7 case. *Ibid.* The decision below turns that clear congressional purpose on its head.

a. More than a decade before Congress added Section 348(f) to the Bankruptcy Code, the Eighth Circuit had concluded that post-petition wages paid to a Chapter 13 trustee remained property of the estate after conversion to Chapter 7 and were not subject to any statutory exemptions. *Resendez* v. *Lindquist*, 691 F.2d 397, 398–399 (1982). In the Eighth Circuit's view, those "funds were voluntarily paid to the Chapter 13 trustee," and it would be "unfair to the unsecured creditors" if they were not available for distribution in the converted case "on the basis that they had not been distributed." *Id.* at 399; accord *In re Lybrook*, 951 F.3d 136, 137, 138

(7th Cir. 1991) (relying on *Resendez*, and holding that "a rule of once in, always in" should apply to post-petition property included in the estate under Chapter 13 "to discourage strategic, opportunistic behavior" that risks giving a "windfall" to debtors); *In re Milledge*, 94 B.R. 218, 219–220 (Bankr. M.D. Ga. 1988); *In re Tracy*, 28 B.R. 189, 190 (Bankr. D. Me. 1983). Motivated by the same perceived policy concerns, other courts had achieved a similar result by authorizing Chapter 13 trustees to distribute to creditors any funds in their possession at conversion. *E.g.*, *In re Redick*, 81 B.R. 881, 883 (Bankr. E.D. Mich. 1987) (adopting this approach despite concluding that "[a] literal reading" of Section 348(a) dictated that undistributed funds "ought to be returned to the debtor" upon conversion); see also *In re Galloway*, 134 B.R. 602, 602–604 (Bankr. W.D. Ky. 1991); *In re Halpenny*, 125 B.R. 814, 815–816 (Bankr. D. Haw. 1991).

By contrast, the Third and Ninth Circuits had held that the property acquired by the debtor while proceeding under Chapter 13 did not remain property of the estate following conversion to Chapter 7. See *In re Bobroff*, 766 F.2d at 803 (concluding that this result also best accords with Congress's goal of "encouraging the use of debt repayment plans rather than liquidation"); *In re Plata*, 958 F.2d at 922 (expressly rejecting the reasoning in *Resendez*).[4]

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[4] The Ninth Circuit's decision in *In re Plata* construed provisions of Chapter 12, which is effectively Chapter 13 for family farmers and family fisherman. See *Hall* v. *United* States, 132 S. Ct. 1882, 1885 (2012) ("Chapter 12 was modeled on

b. By enacting Section 348(f), Congress rejected the very sorts of policy arguments advanced in *Resendez*, *Lybrook*, and *Redick*—and reprised by the Fifth Circuit and respondent here. It "resolve[d]" the debate in the lower courts by establishing the general rule that post-petition property is *not* included in the converted estate. H.R. Rep. No. 835, 103d Cong., 2d Sess. 57 (1994), *reprinted in* 1994 U.S.C.C.A.N. at 3366. In response to concerns, expressed in *Lybrook* and elsewhere, that debtors might behave strategically, Congress also established the exception for cases in which the debtor converts his case "in bad faith." 11 U.S.C. § 348(f)(2).

The final House Report accompanying the bill that enacted Section 348(f) "clearly expressed" that "legislative intention."[5] *Burlington N. R.R. Co.* v. *Okla. Tax Comm'n*, 481 U.S. 454, 461 (1987) (internal quotation marks omitted). In particular, the House Report recognized that several courts had "held that if the case is converted, * * * after-acquired property becomes part of the estate in the converted chapter 7 case, even though the statutory provisions making it property of the estate do not

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Chapter 13.); see also *In re Horne*, No. 97-20171, 2002 WL 33939743, at *4 (Bankr. D. Idaho Jan. 10, 2002) (applying *In re Plata* to funds held by a Chapter 13 trustee upon conversion).

[5] Legislative reports have proven helpful in discerning Congress's intent in cases interpreting other provisions of the Bankruptcy Code. See, *e.g.*, *Marrama* v. *Citizens Bank of Mass.*, 549 U.S. 365, 371–372 (2007) (analyzing House and Senate reports on the enactment of Section 706(a)). It is particularly illuminating here. See *In re Michael*, 699 F.3d at 314–315.

apply to chapter 7." H.R. Rep. No. 835, 103d Cong., 2d Sess. 57 (1994), *reprinted in* 1994 U.S.C.C.A.N. at 3366. And yet other courts had "held that property of the estate in a converted case is the property the debtor had when the original chapter 13 petition was filed." *Ibid.* Congress thus sided with those courts that had held that post-petition property should no longer be property of the estate in a case converted to Chapter 7. See *ibid.* The Report could hardly have been more explicit: "This amendment overrules the holding in cases such as *Matter of Lybrook*, 951 F.2d 136 (7th Cir. 1991) and adopts the reasoning of *In re Bobroff*, 766 F.2d 797 (3d Cir. 1985)." *Ibid.*

This was, the House Report explained, a deliberate policy choice between the competing rationales offered for the decisions on either side of the existing split. Congress enacted Section 348(f) to avoid creating "a serious disincentive to chapter 13 filings" if post-petition property of the estate remained in the estate following conversion to Chapter 7. H.R. Rep. No. 835, 103d Cong., 2d Sess. 57 (1994), *reprinted in* 1994 U.S.C.C.A.N. at 3366; see also *infra* pp. 35–39. And in response to concerns that revesting post-petition property in a debtor upon conversion might encourage strategic behavior, the Report explained that enacting Section 348(f)(2) would be enough to "give[] the court discretion, in a case in which the debtor has abused the right to convert and converted in bad faith, to order that all property held at the time of conversion shall constitute property of the estate in the converted case." *Ibid.*

* * * * *

The text of Section 348(f), especially given the clear purpose for which Congress enacted it, conclusively resolves the question presented. Congress intended that post-petition property of the estate in the Chapter 13 case should not be made available to creditors in the converted case.

B. Section 348(e) "Terminates" The Chapter 13 Trustee's "Service" Upon Conversion

Section 348(e) provides that conversion of a case from Chapter 13 to Chapter 7 "terminates the service of any trustee * * * serving in the case before such conversion." 11 U.S.C. § 348(e). That provision immediately removes the Chapter 13 trustee as "the representative of the estate" (11 U.S.C. § 323(a)) and as the disbursing agent of the former property of the estate in her possession (11 U.S.C. § 1326(c)). Accordingly, Section 348(e) incapacitates a Chapter 13 trustee from doing precisely what respondent did here: continuing to distribute a debtor's post-petition wages to creditors as if the conversion never happened. See *In re Michael*, 699 F.3d at 310 (holding that Section 348(e) "seemingly renders [the trustee] powerless to make payments to creditors under a Chapter 13 plan" after conversion); 3 *Collier on Bankruptcy* ¶ 348.06, at 348-21 ("Because a chapter * * * 13 trustee's service is terminated upon conversion by section 348(e), the trustee has no duty, right, or ability to disburse any funds that the trustee is still holding.").

"[W]hen a statute's language is plain, the sole function of the courts—at least where the disposition required by the text is not absurd—is to enforce it

according to its terms." *Sebelius* v. *Cloer*, 133 S. Ct. 1886, 1896 (2013) (internal quotation marks and brackets omitted). Section 348(e) could hardly be plainer. If Section 348(e) "terminates" *anything*, then surely it terminates the Chapter 13 trustee's authority to continue disbursing funds to creditors. The point of a Chapter 13 case, after all, is the trustee's distribution of a debtor's payments to creditors according to a confirmed plan. Section 348(e) conclusively "terminates" that "service" upon conversion.

The Fifth Circuit concluded, however, that Section 348(e) should not be taken "too literally." Pet. App. 10a (quoting *In re Parrish*, 275 B.R. at 430). "[T]here is no logical reason," the Fifth Circuit believed, "why distribution of funds pursuant to the previously confirmed reorganization plan cannot be included" among the Chapter 13 trustee's remaining "administrative duties" after conversion. *Id.* at 11a (quoting *In re Michael*, 699 F.3d at 320 n.8 (Roth, J., dissenting)). Respondent likewise "posits that 11 U.S.C. § 348(e) * * * cannot be taken too literally." Br. in Opp. 15.

With respect, the Fifth Circuit and respondent have Section 348(e) exactly backward. Following a conversion to Chapter 7, a Chapter 13 trustee has only a small handful of limited, carefully specified duties to carry out. First, "[a]fter qualification of, or assumption of duties by the chapter 7 trustee, any * * * trustee *previously acting* in the chapter 11, 12, or 13 case shall, forthwith, unless otherwise ordered, turn over to the chapter 7 trustee all records and property of the estate in the possession or control of the * * * trustee." Fed. R. Bankr. P. 1019(4)

(emphasis added). Second, the former Chapter 13 trustee "shall * * * transmit to the United States trustee a final report and account." Fed. R. Bankr. P. 1019(5); see also 11 U.S.C. § 1302(b)(1) (incorporating 11 U.S.C. § 704(a)(9)).

Those are "ancillary duties to clean-up and finalize the administration of the estate." *In re Michael*, 699 F.3d at 320. They are not a blank check *to continue* disbursing now-former property of the estate to creditors. Indeed, the requirement that, upon conversion, a Chapter 13 trustee must "turn over to the Chapter 7 trustee all * * * property of the estate" in her "possession or control" directs what a "previously acting" Chapter 13 trustee is supposed to do with any property in her possession that she believes remains available to creditors in the case. Fed. R. Bankr. P. 1019(4). By rule, she must give such property to the Chapter 7 trustee, *not* distribute it to creditors herself.

What is more, the Fifth Circuit's reading would deprive Section 348(e) of consistent meaning in all cases it governs. In a case proceeding under Chapter 7, a trustee has possession and control of *all* the property of the estate. 11 U.S.C. § 704(a)(1). Upon conversion to another chapter, a Chapter 7 trustee also has reporting and other ancillary obligations. See *id.* § 704(a)(9). Yet it would be absurd to suggest that those ancillary duties include distributing the entirety of the estate's property to creditors. That "service" indisputably "terminates" under Section 348(e) upon conversion from Chapter 7. There is no

reason to construe the statute differently when the conversion is from Chapter 13.[6]

Notwithstanding Section 348(e)'s termination of her "service" upon conversion, respondent contended below that Sections 1326(c) and 1327(a) vested creditors with an interest in the post-petition wages in her possession and thus provided her authority to distribute those funds to them. See Resp. C.A. Br. 23–30 & 30 n.5. Section 1326(c) provides that, "[e]xcept as otherwise provided in the plan or in the order confirming the plan, the trustee shall make payments to creditors under the plan." Section 1327(a) likewise "bind[s] the debtor and each creditor" to the confirmed Chapter 13 plan. Each section applies, however, only to cases still proceeding "under" Chapter 13. 11 U.S.C. § 103(i) ("Chapter 13 of this title applies only in a case under such chapter."). Petitioner's case began proceeding under Chapter 7 upon conversion. It is axiomatic that "a Chapter 13 plan has no relevance to or import in a case under any other chapter." *In re Boggs*, 137 B.R. at 410; cf. Pet. App. 18a ("[C]reditors [do not] have a continuing right to payment under the plan after conversion.").[7]

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[6] Distribution of property of the estate is governed by a confirmed plan in Chapter 13, and by statute in Chapter 7. See 11 U.S.C. § 726. But that is a distinction without a difference for purposes of construing a statute that, upon conversion, "terminates the service of any trustee * * * serving in the case before such conversion." 11 U.S.C. § 348(e).

[7] Respondent also contended that Section 1326(a)(2) authorized her post-conversion distributions to creditors. That argument fails for the same reason, and for the additional

In short, Section 348(e) unambiguously terminated respondent's service as trustee in petitioner's case the moment petitioner converted his case to Chapter 7. Neither respondent's remaining "ancillary duties" to turn over the property of the estate and report on its administration, nor provisions of Chapter 13 that ceased to govern the case upon its conversion, provide any authority to distribute post-petition wages following such termination.

C. Section 1327(b) Vests Any Property Of The Estate Held By The Chapter 13 Trustee In The Debtor At Or Before Conversion

Section 1327(b) establishes a default rule that "vests all of the property of the estate in the debtor" upon confirmation of a Chapter 13 plan, "[e]xcept as otherwise provided in the plan or in the order confirming the plan." 11 U.S.C. § 1327(b). In this case, the confirmation order "otherwise provided" that "[s]uch property as may revest in the Debtor shall so revest only upon further Order of the Court or upon dismissal, *conversion*, or discharge." J.A. 48 (emphasis added). Accordingly, all the property of the estate under Chapter 13—whether in petitioner's possession or the trustee's, see 11 U.S.C. § 1306(b)—revested in petitioner when he converted his case to Chapter 7. That revesting of the estate's property—

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reason that Section 1326(a)(2) "does not apply to post-confirmation payments made by the debtor to the trustee," but rather to pre-confirmation payments not at issue here. Pet. App. 15a–17a; see also pp. 33–34 & n.8, *infra*.

whether it happens at plan confirmation or at a time "otherwise provided" for by the plan or confirmation order—thus gives the debtor an unambiguous, vested interest in post-petition wages held by a Chapter 13 trustee at conversion. See *In re Michael*, 699 F.3d at 313; see also *Nash* v. *Kester (In re Nash)*, 765 F.2d 1410, 1414 (9th Cir. 1985) (payments to a Chapter 13 trustee under a confirmed plan vested in the debtor per Section 1327(b)).

The Fifth Circuit, by contrast, misconstrued Section 1327(b), concluding that a confirmed plan's provision for a debtor's monthly payment to a Chapter 13 trustee "otherwise provide[s]" that such property of the estate shall *never* revest in the debtor. See Pet. App. 19a–21a & n.8. It is an "exception to [the] possession and vesting of title in [the] debtor," the court of appeals reasoned, "[that] indicate[s] that [the] debtor is to have *no continuing interest* in payments actually made pursuant to a confirmed plan." *Id.* at 20a (quoting *In re Lennon*, 65 B.R. 130, 136 (Bankr. N.D. Ga. 1986)) (emphasis added). But the court identified no statutory basis for treating property in a trustee's possession because of monthly payments different from property in petitioner's possession for purposes of revesting the property of the estate in petitioner "upon * * * conversion." J.A. 48.

In fact, the court of appeals correctly *rejected* respondent's principal statutory argument in support of that counterintuitive result. "Relying primarily on 11 U.S.C. § 1326(a)(2)," respondent had argued "that creditors obtain a vested right to receive payments pursuant to a confirmed Chapter 13 plan once the debtor transfers the payments to the trustee." Pet.

App. 14a; see also *id.* at 17a–18a. The Fifth Circuit squarely held that there is "no support for such a rule in the Bankruptcy Code or in any legislative history." *Id.* at 18a. As many other courts have also recognized, "[n]o provision in the Bankruptcy Code classifies any property, including post-petition wages, as belonging to creditors." *In re Michael*, 699 F.3d at 312-313; accord *In re Murphy*, Nos. 09-81861, 12-30813, 2014 WL 2600168, at *2 (Bankr. M.D. Ala. Feb. 11, 2014); *In re Boggs*, 137 B.R. at 409–410. Rather, "[a] Chapter 13 creditor's interests do not vest *until the monies are distributed*. Because the monies here in question were not distributed [prior to conversion], * * * [t]he debtors' interests in the monies [had] not been extinguished." *In re Plata*, 958 F.2d at 922 (quoting *Resendez*, 691 F.2d at 400 (Bright, J., dissenting)).

In particular, nothing in Sections 1326 purports to vest Chapter 13 creditors with a right to undistributed wages. Those provisions provide only that, upon plan confirmation, a trustee "shall distribute" any payments received before plan confirmation "in accordance with the plan as soon as is practicable," 11 U.S.C. § 1326(a)(2),[8] and that a

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[8] Several courts have recognized that Section 1326(a)(2) is "limited to postconfirmation distribution of the debtors' *preconfirmation* payments to a trustee." *Williams* v. *Marshall*, No. 13 C 2326, 2014 WL 1457828, at *4 (Bankr. N.D. Ill. Apr. 11, 2014); accord *Cohen* v. *Tran (In re Tran)*, 309 B.R. 330, 335 (Bankr. App. 9th Cir. 2004) ("[Section] 1326(a)(2) was not intended to address the disposition of funds received by a chapter 13 trustee after confirmation."); *In re Hamilton*, 493 B.R. 31, 35 (Bankr. M.D. Tenn. 2013) (citing cases).

"trustee shall make payments to creditors under the plan," 11 U.S.C. § 1326(c). That is to say, Congress was merely addressing "when plan payments are to begin, the disposition of funds in the event no plan is confirmed, and who is to handle the funds." *In re Boggs*, 137 B.R. at 410; accord *In re Nash*, 765 F.2d at 1413 n.1 (holding that what is now Section 1326(c) "was intended to address only the question of who should act as disbursing agent (debtor, trustee, or someone else) of the Chapter 13 plan funds") (citing H.R. Rep. No. 595, 95th Cong., 1st Sess. 430 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6386, and 5 *Collier on Bankruptcy* ¶ 1326.01[4], at 1326–1328 (15th ed., Lawrence P. King ed., 1985)).

In short, when petitioner converted to Chapter 7, all of his property—including all of his post-petition wages—was "[p]roperty of the estate." 11 U.S.C. § 1306(a). He possessed the bulk of that property, see 11 U.S.C. § 1306(b), but had remitted some of that property to the trustee's possession and control, see 11 U.S.C. § 1322(a)(1). The fact that *some* property of the estate is held by the trustee has no bearing on the debtor's vested interest in *all* of that property at or before conversion. *In re Michael*, 699 F.3d at 313; see also *In re Plata*, 958 F.2d at 922 (reaching the same conclusion under Chapter 12). Given its correct conclusion that no statute gave creditors any vested right to the property of the estate held by the trustee, the Fifth Circuit should have recognized that the plain meaning of Section 1327(b), and the confirmation order entered in this case, directed the revesting of those funds in petitioner and their refund to the rightful owner.

II. Post-Conversion Distributions Would Create Perverse Incentives Contrary To Congressional Intent

A. Post-Conversion Distributions Penalize Debtors For Proceeding Under Chapter 13

"Congress intended Chapter 13 proceedings to be entirely voluntary," *Tidewater Fin. Co.* v. *Williams*, 498 F.3d 249, 252 (4th Cir. 2007); a debtor cannot be compelled to commence *or to continue* a Chapter 13 case. Only the debtor can file a Chapter 13 case, see 11 U.S.C. §§ 301–303, and he enjoys the right to convert or (unless previously converted) to dismiss the case "at any time," 11 U.S.C. § 1307(a), (b). As one bankruptcy court put it:

> [M]ost Chapter 13 debtors literally volunteer to pay their creditors money they don't have to pay to realize bankruptcy relief. They could file Chapter 7 instead, walk away from all their debts without further payment and keep all future earnings from personal services free of the claims of prepetition creditors. By filing Chapter 13 instead, these individual debtors are voluntarily paying some or all of their dischargeable debt from future earnings that would otherwise be immune to the claims of their creditors.

In re Hamilton, 493 B.R. at 42.

An important purpose of the Bankruptcy Code is to encourage eligible individuals to make that election. Nearly half a century ago, addressing Chapter 13's predecessor—Chapter XIII of the Bankruptcy Act, Pub. L. No. 75-696, 52 Stat. 840,

930 (1938), as amended—this Court recognized that "Congress clearly intend[s] to encourage [individuals with regular income] to pay their debts in full, rather than to go into straight bankruptcy." *Perry* v. *Commerce Loan Co.*, 383 U.S. 392, 395 (1966). That is because in a liquidation, under what is now Chapter 7, "everyone los[es]—the creditors by receiving a mere fraction of their claims, the debtor by bearing thereafter the stigma of having been adjudged a bankrupt." *Ibid.* In enacting the current Bankruptcy Code, Congress doubled down on its enticement of debtors into Chapter 13. At every turn, the Code "encourages more debtors to repay their debts over an extended period rather than to opt for straight bankruptcy liquidation and discharge." H.R. Rep. No. 595, 95th Cong., 1st Sess. 5 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 5966.

The reason is simple: Under Chapter 13, everyone wins. "The benefit to creditors is self-evident: Their losses will be significantly less than if their debtors opt for straight bankruptcy." H.R. Rep. No. 595, 95th Cong., 1st Sess. 118 (1977), *reprinted in* 1978 U.S.C.C.A.N. at 6079; see also *Perry*, 383 U.S. at 395–396 (recognizing that individual debtors "ordinarily have little or no assets available for distribution in straight bankruptcy," which results in creditors "receiving a mere fraction of their claims"). In particular, a Chapter 13 plan must provide for payments to unsecured creditors at least as great as the sum they would receive in a Chapter 7 liquidation. 11 U.S.C. § 1325(a)(4). In many cases, moreover, unsecured creditors stand to receive *nothing* in a liquidation; *something* is undoubtedly better than nothing. See, *e.g.*, *Wachovia Mortgage*, 478 B.R. at 560 ("[M]ost chapter 7 cases are actually

no asset cases, meaning that there is nothing to liquidate and unsecured creditors are never repaid.").

For debtors, Chapter 13 avoids the disruption of asset liquidation, affords them the opportunity to repay their debt over an extended period, and accordingly bestows less of a stigma. See H.R. Rep. No. 595, 95th Cong., 1st Sess. 118 (1977), *reprinted in* 1978 U.S.C.C.A.N. at 6079. Chapter 13 debtors are allowed to keep most of the property of the estate while they implement their plan (11 U.S.C. § 1306(b)), and they receive a discharge upon successful plan completion that is broader than the discharge available to Chapter 7 debtors.[9]

The principal risk of electing or continuing a Chapter 13 case is failure. The Chapter's primary benefits are largely lost to the debtor who does not successfully complete a confirmed Chapter 13 plan. In the meantime, the debtor will have contributed disposable income to the estate that would have been excluded from the estate's property in a case under Chapter 7. That risk is very real: The bulk of Chapter 13 plans are not successfully completed. Katherine Porter, *The Pretend Solution: An Empirical Study of Bankruptcy Outcomes*, 90 Tex. L. Rev. 103, 108 & nn.33–34 (2011). Debtors (and their counsel) are naturally attuned to these potential

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[9] Compare 11 U.S.C. § 727(b) with 11 U.S.C. § 1328(a). The so-called "super discharge" in Chapter 13 applies to certain debts that are not dischargeable in Chapter 7, including marital property settlements other than support, claims of willful or malicious injury to property, and certain civil fines, penalties, and forfeitures.

negative consequences that flow from having to convert or dismiss their Chapter 13 cases.

A severe penalty such as respondent's post-conversion distribution of $4,319 of petitioner's wages is a clear disincentive to proceeding under Chapter 13 in the first place. As one bankruptcy court remarked, "the Congressional policy of encouraging debtors to repay their creditors via Chapter 13 is furthered by debtors (and their counsel) knowing they will not be penalized for attempting Chapter 13." *In re Boggs*, 137 B.R. at 411. For debtors who are volunteering to put their future income at risk, it is important that undistributed wages will be returned to them if they must abandon their volunteerism through conversion. "This result furthers Congress's preference that on conversion to Chapter 7 a Chapter 13 debtor receive all post-petition property that is held by the Chapter 13 trustee, but still is under the control of the debtor, so that debtors are encouraged to attempt to repay their debtors through reorganization rather than liquidation." *In re Michael*, 699 F.3d at 316. The contrary "outcome," adopted by the court of appeals below, "would dissuade debtors from filing under Chapter 13." *Id.* at 315.

This case illustrates this powerful disincentive. As the district court recognized, respondent's post-conversion distributions created "precisely the kind of disincentive to file a Chapter 13 bankruptcy that Congress was trying to avoid." Pet. App. 48a. Until converting his case, petitioner had been making monthly payments to the Chapter 13 trustee for "over a year and a half" that "would not have been part of the Chapter 7 estate if Debtor had filed a

Chapter 7 petition originally." *Ibid.*; see also *DeHart* v. *Michael*, 446 B.R. 665, 669 (M.D. Pa. 2011), *aff'd*, *In re Michael*, 699 F.3d 305 (3d Cir. 2012) (holding post-confirmation distributions "reduce[] the incentive to attempt reorganization" under Chapter 13).

When respondent distributed $4,319 of those funds—eight months' worth of petitioner's total disposable income—to creditors, she deprived petitioner of the ability to use those funds to make his fresh start after Chapter 7. Petitioner had reported just $1,100 in cash savings when he filed his original petition, and since then had lost his house and his car. The refund of his undistributed wages would significantly boost petitioner's ability to pay his non-dischargeable debt (like his student loans), and otherwise to help him get back on his feet. Congress provided that any property and earnings the debtor acquired after commencing his case that remained undistributed would revert to the debtor upon conversion. That legislative judgment should be respected.

B. Post-Conversion Distributions Create An Illogical Disparity Between Debtors Who Convert And Those Who Dismiss

If upheld, the decision below would create an anomaly. It would give an improper windfall to creditors based solely on the procedural vehicle the debtor happened to choose for exiting Chapter 13. A debtor who *dismisses* a Chapter 13 case is plainly entitled to any post-petition wages held by the Chapter 13 trustee absent "cause." There is no

logical reason for a different rule to govern conversions.

"On request of the debtor at any time * * * the court *shall dismiss* a [Chapter 13] case." 11 U.S.C. § 1307(b) (emphasis added)). Section 349 governs the effects of such a dismissal; it provides that, "[u]nless the court, *for cause*, orders otherwise," the property of the estate revests in the debtor—including any post-petition wages held by the Chapter 13 trustee. 11 U.S.C. § 349(b)(3) (emphasis added).[10]

The Third and Ninth Circuits have rightly rejected the pointless formalism that would have undistributed funds treated differently upon conversion than upon dismissal. As Judge Ambro explained in *In re Michael*, "if a Chapter 13 debtor is concerned about obtaining funds held by the Chapter 13 trustee, he can dismiss his case rather than convert. As noted by the Ninth Circuit Court, we can discern 'no justification for requiring a debtor to dismiss, rather than convert'" to obtain those funds. 699 F.3d at 314 n.6 (quoting *In re Plata*, 958 F.2d at 922). "Aside from creating a trap for the unwary, such a requirement would merely elevate form over

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[10] In her Brief in Opposition (at 20), respondent contended that she "would have * * *, as she has in the past * * *, argued that funds in her possession at time of dismissal should be distributed to creditors as opposed to the Debtor." What respondent failed to state, however, is that the district court *rejected* her argument in the very appeal she cites (Opp. 20 n.7). See Memo. Op. 10, *Clark* v. *Viegelahn*, No. 12-CA-979, Doc. 7 (W.D. Tex. July 9, 2013) (holding that respondent's argument "creates a host of problems that evaporate when section 349 is fully respected"); see also *In re Nash*, 765 F.2d at 1414–1415.

substance and inject a needless degree of extra work on the part of all concerned." *Ibid.* (same).

What is more, a debtor who obtained undistributed funds from the trustee upon dismissal, and who met the eligibility requirements, could then file a new petition under Chapter 7. The new petition would create a new estate that included all of the cash in the debtor's control—including the recently refunded, now-*pre*-petition wages. 11 U.S.C. § 541(a). In most cases, however, the debtor would be entitled to exempt those funds from the new estate up to limits set by Section 522(d).[11] Thus, many debtors could avoid the anomalous result produced by the decision below by proceeding under the Code's dismissal provisions.

Suppose, for example, that petitioner had dismissed his Chapter 13 case under Section 1307(b), and upon doing so received the $4,319 held by respondent per Section 349(b)(3). If thereafter he had filed a new case under Chapter 7, he would have been able to exempt every penny of those funds from the resulting estate under 11 U.S.C. § 522(d)(5). See Bankr. Pet. Schedule C-1 (disclosing that petitioner had $7,646.91 in unused exemption under Section 522(d)(5) upon filing his petition under Chapter 13).

The Fifth Circuit offered no explanation for that obvious incongruity. It merely noted that dismissal and conversion are separate vehicles for exiting

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[11] More specifically, Section 522(d)(5) authorizes a debtor to exempt as much as $8,300 from the property of the estate ($800 plus up to $7,500 of any unused exemption for interests in real property under paragraph (d)(1)).

Chapter 13, and that they are governed by separate Code provisions. See Pet. App. 11a–12a. That fails to explain why Congress would have intended to employ the procedural difference as a trap for the unwary debtor who chooses between them unwisely. See *Food & Drug Admin.* v. *Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000) ("A Court must * * * interpret the statute as a symmetrical and coherent regulatory scheme and fit, if possible, all parts into an harmonious whole.") (internal citations and quotation marks omitted). Accordingly, even if the Bankruptcy Code leaves a gap to be filled by "considerations of equity and policy" (but see pp. 19–34, *supra*), the fair and equitable approach is to require Chapter 13 trustees to return undistributed funds to debtors upon conversion, just as they are required to upon dismissal.

C. Post-Conversion Distributions Upend Debtors' Superior Interest In Undistributed Wages

The Fifth Circuit believed that returning a debtor's post-petition wages to him if those wages are undistributed at conversion would provide to him a "windfall" and deprive creditors of their "*quid pro quo*" under the confirmed Chapter 13 plan. Pet. App. 25a–26a (quoting *In re Michael*, 699 F.3d at 319–320 (Roth, J., dissenting)). It does neither.

1. A refund to debtors upon conversion of their undistributed wages is not a "windfall." When a debtor remits wages to a Chapter 13 trustee under a confirmed plan, he does so only to complete that plan and obtain a discharge of his debts. But "[w]hen a Chapter 13 plan does not work out" and the debtor

converts to Chapter 7, "no reason of policy suggests itself why the creditors should not be put back in precisely the same position as they would have been had the debtor never sought to repay his debts by filing under Chapter 13." *Hannan* v. *Kirschenbaum (In re Hannan)*, 24 B.R. 691, 692 (Bankr. E.D.N.Y. 1982); see also *In re Boggs*, 137 B.R. at 410–411.

Respondent has contended, however, that requiring those refunds will mean that creditors' ultimate recovery under a confirmed plan will turn—at least on the margins—on when a conversion notice falls during the trustee's distribution schedule. See Resp. C.A. Br. 20. That may well be true in some cases, but it is the direct and obvious result of Congress's decision to allow debtors to convert their Chapter 13 cases to Chapter 7 immediately and "at any time." 11 U.S.C. § 1307; see also Fed. R. Bank. P. 1017(f)(3). This "practical consequence" (*In re Michael*, 699 F.3d at 316) is thus fully consistent with the statutory scheme.

In any event, in this case it was petitioner's conversion notice that spurred respondent to schedule a distribution to creditors, not *vice versa*. Respondent had been accumulating funds earmarked for Chase for a year when, on November 21, 2011, petitioner converted his case to Chapter 7. It was only nine days *after* petitioner's conversion notice that respondent filed a local form stating her recommendation concerning the treatment of claims in the already-converted Chapter 13 case (J.A. 7–8, Doc. 34), and a day *after that* when she distributed the accumulated funds. Petitioner did not strategically time his conversion; if anything, respondent strategically timed her distribution to get

it in before her final report was due. Even if the facts were otherwise, Section 348(f)(2) is Congress's response to a debtor's attempt to "game the system" in bad faith, and it is undisputed that petitioner acted in good faith here. See pp. 8–9, *supra*; Pet App. 47a; *In re Michael*, 699 F.3d at 316.

Nor is the timing of conversion or distributions entirely in the debtor's control. If petitioner's unsecured creditors had believed they were entitled to the accumulating funds *during* the Chapter 13 proceedings, they could have moved to modify the plan to provide for their payment ahead of Chase. See 11 U.S.C. § 1329. No creditor did so. What is more, if unsecured creditors truly believed petitioner was using his Chapter 13 case as a "savings account," Pet. App. 42a (quoting Resp. D.C. Br. 23), they also could have moved to convert the case to Chapter 7 or to dismiss it. 11 U.S.C. § 1307(c). Again, no creditor did so. For these reasons, no "strong considerations of fairness" give creditors who slept on their rights any "superior" claims to petitioner's post-petition wages upon conversion. Pet. App. 26a, 28a.

2. As even the Fifth Circuit recognized, *nothing* in the Bankruptcy Code gives creditors a "vested right to receive * * * funds." *Id.* at 17a; see pp. 32–34, *supra*. Here, moreover, the bulk of the creditors to which respondent distributed funds after conversion had no entitlement under the confirmed plan to receive those payments from the estate so early in the case. See J.A. 30; Pet. App. 17a ("When [petitioner] converted to Chapter 7, [respondent] distributed the accumulated funds to other creditors, who would never have received them if they had

been distributed to Chase as originally intended."). As to those creditors in particular, the funds held by the trustee were neither *quid* nor *quo*.

What is more, this case demonstrates why it is odd to treat Chapter 13 payments held by the trustee as belonging to a creditor. Petitioner, like many debtors, converted his case from Chapter 13 to Chapter 7 precisely because the benefits he had hoped to receive under Chapter 13 did not materialize. When petitioner converted his case—just as when the debtor in *In re Michael* converted his, 699 F.3d at 307—he had already lost his home when Chase moved to lift the automatic stay, see Pet. App. 4a. Petitioner also did not "retain the use of his automobile," *id.* at 26a–27a (quoting *In re Michael*, 699 F.3d at 319): he had surrendered his car to the secured lender on his car loan, see *id.* at 27a n.12. Moreover, as in *In re Michael*, the funds the Chapter 13 trustee held at conversion had been deducted from the debtor's wages only *after* he had failed to "stave off foreclosure and cure the mortgage default." *Id.* at 26a (quoting *In re Michael*, 699 F.3d at 319 (Roth, J., dissenting)). In sum, by the time petitioner converted, the benefits offered by attempting to proceed in Chapter 13 had evaporated.

The Fifth Circuit's preferred policy rationale was also mistaken in emphasizing the purported "disadvantages" creditors "suffer[] as a result of [a Chapter 13] plan." Pet. App. 27a. Chapter 13 plans, by definition, provide unsecured creditors at least as much as they can expect to receive under standard Chapter 7 liquidation. See 11 U.S.C. § 1325(a)(4). Indeed, Chapter 13 puts such creditors in a *better* position because, during the pendency of the Chapter

13 plan, they enjoy the "benefit of distribution from debtors' wage contributions, which would not have been available to them under Chapter 7." Pet. App. 46a (quoting *In re Boggs*, 137 B.R. at 410). Creditors are virtually always better off if a debtor first attempts to proceed under Chapter 13 and then converts than they are if the debtor files immediately under Chapter 7.

Again, this case is instructive. When petitioner filed for bankruptcy protection, his only non-exempt assets were his home and his car. See Bankr. Pet. Schedule C-1. He gave up the car, and if he had filed his case under Chapter 7 from the start (or converted it months earlier than he did), then his home would have been sold, his mortgage lender would have received the proceeds, and the rest of his debts would have been discharged to the extent authorized by law. It was only petitioner's attempt to proceed under Chapter 13 in an effort to save his home that provided his other creditors any opportunity to recover anything at all. Ultimately, the only "harm" to the creditors was that petitioner did not see his Chapter 13 plan through to completion, but that was his choice—not his creditors'—under 11 U.S.C. § 1307(a).

CONCLUSION

The judgment should be reversed.

Respectfully submitted.

J. TODD MALAISE
STEVEN G. CENNAMO
MALAISE LAW FIRM
909 N.E. LOOP 410, STE. 300
SAN ANTONIO, TEXAS 78209
(210) 732-6699

MARK T. STANCIL
Counsel of Record
ALAN E. UNTEREINER
MATTHEW M. MADDEN
ERIC A. WHITE
ROBBINS, RUSSELL, ENGLERT, ORSECK, UNTEREINER & SAUBER LLP
1801 K STREET, NW
WASHINGTON, D.C. 20006
(202) 775-4500
mstancil@robbinsrussell.com

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